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October 21, 2016

Electronic Delivery

The Honorable John Chiang
California State Treasurer
Chairman, California Secure Choice Retirement Savings Program
915 Capitol Mall, Room 110
Sacramento, CA 95814

RE: Professional Employer Organizations (PEOs) and Administration of the Secure Choice Program.

Dear Chairman Chiang:

On behalf of the members of the National Association of Professional Employer Organizations[1] (NAPEO), I would like to thank you for the opportunity to discuss the implementation of SB 1234. NAPEO is the largest trade association for professional employer organizations (PEOs), representing 300 PEO members that provide services to over 156,000 businesses employing more than 2.7 million people nationwide. In California, NAPEO has over 60 California member PEOs, who offer a variety of comprehensive human resources solutions to over 105,000 California workers collectively. With the passage of SB 1234, we are writing to assist you and the Secure Choice Board to identify issues NAPEO believes should be addressed as part of the implementation of the Secure Choice program.

Generally speaking, SB 1234 was drafted with a traditional "two-party" employment relationship (employer-employee) in mind. This construct presents certain ambiguities, however, in the many different "three-party" employment relationship contexts (temporary agencies, staffing companies, and PEOs) that cover a significant percentage of California workers[2]. Moreover, significant differences between these types of three-party relationships make it even more important for your Board to clarify

[1] A professional employer organization (PEO) provides comprehensive HR solutions for small and mid-size businesses. Payroll, benefits, HR, tax administration, and regulatory compliance assistance are some of the many services PEOs provide to growing businesses across California and the nation.

[2] SB 1234 speaks in terms of the "eligible employer" (Government Code sections 100000(d)(1)), but does not clearly identify whether the "eligible employer" should be the on-site "client employer" or the third party (such as the PEO) which may be treated as an "employer" for certain purposes under state and federal law.

the responsibilities of the parties involved so the Secure Choice system operates smoothly and as envisioned by the Legislature. While these relationships and ambiguities will be discussed in more detail below, the intent and language of SB 1234 suggest that "employer" in the PEO context means the on-site, "client employer". This fundamental distinction lies at the root of virtually all of the issues created by the bill.

PEOs differ significantly from temporary agencies and so-called "staffing companies". With rare exceptions, PEOs take the existing workforce of a business and during the course of the contractual relationship with the business assume an employment relationship with that business' workers for certain limited purposes, which include payroll administration and contractually-specified benefits. Unlike temporary or staffing agencies, however, PEOs generally do not engage in recruitment or hiring of new employees in their own name for the purposes of supplementing a client's existing permanent workforce. Similarly, PEOs do not "hire" workers to be assigned out to client businesses for varying job assignments, as is the norm with temporary and staffing agencies.

It is NAPEO's belief that compliance and financial responsibility should be placed at the client employer level. Client employers often move in and out of PEO relationships in the course of any given time period. If compliance responsibility (reporting, determination of eligibility, record retention, etc.) were placed at the PEO level, not only would compliance tracking be problematic when the client employer leaves the PEO relationship, or engages a different PEO, but unintended negative consequences could be potentially created for the worker as well.

For example, if an employee had previously opted out of the Secure Choice program when the client employer was not with a PEO, they could easily be unaware of an automatic enrollment feature upon the initiation of a new PEO arrangement and may ignore subsequent notice to opt out again. That worker may be surprised by a sudden unanticipated decrease in their paycheck which could make it difficult for them to meet their existing monthly financial obligations.

Finally, compliance and financial responsibility should be placed at the client employer level because the client employer controls much of the relevant information to determine client and employee eligibility, including the employee's period of service and hours worked. This issue of control of the relevant information is particularly troublesome with regard to determining the eligibility of part-time or temporary employees.

For these reasons, NAPEO suggests that a PEO's responsibility be limited to making the deductions from the employee's paycheck, crediting them back to the client employer and having the client employer remit them to the state agency. This is current procedure for how many, if not most PEOs that handle situations when the client employer has its own retirement plan and chooses not to involve the PEO with recordkeeping.

Consistent with that view, NAPEO believes Secure Choice's regulations should clarify that PEO client-employers that provide their employees with access to an employer-provided 401k plan (either sponsored by the PEO or by the client) should be treated as having provided an offer of an employer sponsored plan to their employees. It should be made equally clear that a client-employer of a PEO that does *not* opt to offer their employees a retirement plan option through their involvement with their PEO *is* obligated to participate through the Secure Choice program. This also makes sense because if a PEO offers a retirement plan but the client employer chooses not to have that offer extended to its workforce, the client employer should assume the responsibility for compliance with the Secure Choice and be considered the "eligible employer," not the PEO.

We have additional observations for your consideration:

- Remittance of payroll deductions to a third party (state agency[3] or state-designated recordkeeper)
    - Preferably, client employers would be responsible to remit deductions to the IRA/trust. Many PEOs may not have the ability to remit funds directly to multiple recordkeepers (if the Board decides on individually-managed plans in the future), and there are significant concerns on how the funds would be remitted. The responsibility for failure to remit funds should rest with the client employer, not the PEO. However, in the event a PEO wishes to provide assistance to a client employer with remitting deductions, we would request PEOs be permitted to remit such deductions on behalf of the client employer
    - If PEOs are to be responsible to remit the funds, there should be a single location/recordkeeper for all remittances. This would be the case if the Board opts to have Secure Choice itself manage the employee funds. Otherwise, a PEO with hundreds of clients could have extensive time and financial impact to remit to multiple different locations. As noted above, this appears to be the direction, at least for the first three years of implementation.
    - If an employee can eventually designate a variety of IRA custodians, then the client employer remitting the contributions should be entitled to rely upon the employee's direction and be relieved of liability for any delayed or improper account establishments, investment delays or other similar events beyond the employer's control.

[3] It appears (though not completely certain) that Government Code sec. 100002(e) contemplates (at least for the first three years of the program, that a "pooled" approach will be the model for Secure Choice, and that if individual, self-directed accounts are ever contemplated, the approval of the Legislature is required. (Government Code sec. 100002(e)(2)(B)).

- A standardized format for file feeds should be developed with recordkeepers to ease the remittance process, and restrictions should be implemented to prevent unilateral file format changes by recordkeepers without adequate notice to implement any changes.
- Regardless of who is responsible to remit funds, there should be a specified safe harbor time period to remit funds without penalties after they are withheld. This period should correspond with the Department of Labor Safe Harbor rule for small plans as outlined under 29 CFR § 2510.3-102(a)(2).

- Additional Compliance Issue

  - Determination of "eligible employers" should be based on the size and location of the client (not based on size or location of the PEO). This is a particular concern now that SB 1234 contains a phase-in provision based on the number of eligible employees (Government Code section 100032(b) and (c)). To the degree that the phase-in is measured at the PEO level instead of the client employer level, it could have the unintended consequence of drawing our client employers into the participation requirement prior to the time that the legislature intended.

We appreciate the opportunity to present our views on the implementation of SB 1234 to you and the Board. Please feel free to contact use if we can provide additional information about our position on this matter.

Sincerely,

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December 7, 2017

Electronic Delivery

California Secure Choice Retirement Savings Investment Board
Attention: Katie Selenski, Executive Director
915 Capitol Mall, Room 435
Sacramento, CA 95814
SecureChoice@sto.ca.gov

Re: Need for Additional Clarity in the Secure Choice Regulations for Employment Situations Involving Professional Employer Organizations

Dear Ms. Selenski:

On behalf of the National Association of Professional Employer Organizations (NAPEO), I would like to convey NAPEO's appreciation for the opportunity to provide comments on the draft regulations for California's Secure Choice Program (Program). NAPEO further appreciates the efforts that Program staff have made to involve stakeholders in the regulatory process. We were pleased to see in the draft regulations that staff took seriously the need to clarify at the outset who the "Employer" is for purposes of the Program in certain "tri-party" employment situations in which more than one individual or entity might be viewed as the employer of an employee. However, as discussed below, ***we believe that further clarification is needed for those situations involving a professional employer organization (PEO) in order to more fully and consistently achieve the Program's policy objectives and desired results for California workers and small businesses***.

NAPEO is the largest trade association for professional employer organizations (PEOs), which provide comprehensive HR solutions for small and mid-sized businesses. NAPEO represents approximately 300 PEO member companies that provide services to over 156,000 businesses employing more than 2.7 million workers nationwide. In California, NAPEO has over 60 California member PEOs who provide their services to over 105,000 California workers collectively.

PEOs generally provide payroll, benefits (including retirement plans), regulatory compliance assistance, and other HR services to their clients (referred to herein as "client employers"). Client employers have on average 10-15 workers. They tend to grow faster, have lower employee turnover, and are less likely to go out of business than small businesses that do not use a PEO. As described in our previous letter to California State Treasurer and California Secure

Choice Retirement Savings Investment Board (Board) Chair John Chiang,[1] a PEO's relationship with its client employers differs significantly from temporary agencies and so-called staffing agencies in part because ***PEOs generally assume a co-employment relationship with a client's workers for certain limited purposes*** such as payroll administration and contractually specified benefits. As a result, it is critical that the Program's regulations specifically address the responsibilities of PEOs and their clients in a manner that best achieves the objectives of the Program. Our recommendations (which are consistent with the approach that has been taken in connection with OregonSaves) are described below.

Our comments address the following:

1. Background on the need for Program regulations to clarify the treatment of tri-party employment relationships.
2. NAPEO's general recommendations for the Program's treatment of PEOs and their client employers in order to better and more consistently achieve the Program's desired outcomes for California workers and small businesses.
3. The challenges associated with applying Unemployment Insurance Code Section 606.5 for purposes of the definition of "Employer" to PEOs and their clients, and why further clarification specific to PEOs is needed in the regulations.
4. Specific recommendations for changes to the draft regulations to address employment situations that involve a PEO.
5. Other technical and procedural recommended changes not specific to PEOs.

1. THE NEED FOR PROGRAM REGULATIONS TO CLARIFY THE TREATMENT OF TRI-PARTY EMPLOYMENT RELATIONSHIPS

As noted in our previous letter to Mr. Chiang, the Secure Choice Program legislation (S.B. 1234) was generally drafted with a traditional "two-party" employment relationship in mind (i.e., one employee and one employer). A two-party employment relationship is the most typical type of relationship that workers have with employers. Even workers who hold multiple jobs would generally be considered as having entered into separate two-party employment relationships with each employer for whom the worker performs services.

Despite the prevalence of two-party employment relationships, there are several forms of "tri-party" employment relationships that exist in certain contexts and that cover a significant number of California workers. A tri-party relationship generally consists of an employee, a client business, and a third individual or entity (e.g., a temporary agency, staffing company, or PEO) that enters into a service contract with the client business. Depending in part on the type of individual or entity involved and the specific arrangement that such individual or entity has with the client business, either party could be treated as the employer of the employee for certain purposes under state and federal law. S.B. 1234, however, does not address who the employer is in tri-party employment relationships.

[1] See the attached October 21, 2016, letter from NAPEO to The Honorable John Chiang.

Thus, for purposes of the Program, there is a need for the regulations to clarify in tri-party employment relationships whether the client business *or* the individual or entity that contracts with the client business is the "Employer" with all the attendant responsibilities of an Employer under the Program.[2] How the Board and Program staff choose to address this matter for the various forms of tri-party employment relationships will have significant implications with respect to worker coverage under the Program, the employee experience, and administrative complexity for small businesses and PEOs (or temporary agencies or staffing companies).

2. General Recommendations for the Treatment of PEOs under the Program

Unlike other tri-party employment relationships, when a PEO establishes its unique co-employment relationship with a client employer, that relationship is intended to assist the client employer with its compliance issues and the offering of employee benefits to the client's existing workforce – services that are particularly helpful to small businesses. Yet a PEO's clients and the employees that work for those client employers would exist and carry on their business regardless of whether the PEO is in the picture. In other words, if a client employer terminates its contract with a PEO, the workers who were covered by the contract remain with the client employer.

As such, the most consistent and lasting employment relationship in this tri-party arrangement is the relationship that exists between the client employer and its own workers – not the PEO and such workers. It is this unique nature of co-employment (i.e., unique to temporary agencies, staffing companies, and even joint employment) that necessitates the inclusion of separate rules for PEO relationships in order to better ensure that (1) the objectives of the Program are met and (2) workers and small businesses are treated consistently and equitably regardless of whether a PEO relationship is present.

NAPEO has therefore strongly advocated that the following principles be incorporated into any rules developed for state-run retirement programs such as California's Secure Choice Program and OregonSaves:

1. **The client employer – and not the PEO – should be treated as the employer for all employer requirements under the program with respect to workers who are performing services for the client employer and who are covered by the contract between the client employer and the PEO.**[3]
2. **Any program requirements that are based on the number of employees an employer has should be applied at the client employer level with respect to the workers who are covered by the contract.**

[2] We would note that a worker who holds multiple jobs could have multiple "Employers" for purposes of the Program, with each Employer potentially being required to enroll the worker in the Program and perform its respective duties as an Employer with respect to the Program. However, a worker who is subject to a tri-party employment relationship should only be treated as having one Employer for purposes of the services performed for the client business. Treating both the client and the individual or entity that contracts with the client as Employers would lead to substantial confusion, overlap, and conflicting actions, and we strongly believe that this result would not have been the intent of the Legislature.

[3] Client employers are generally treated as the employer (rather than the PEO) in several other contexts, including under both federal and state law.

3. **Client employers that offer a PEO-sponsored retirement plan to their employees should be treated as offering or providing an employer-sponsored retirement plan (i.e., a Tax-Favored Retirement Plan) for purposes of the program and any employer exemption that is based on the employer's offering of a retirement plan.**

By incorporating the above principles into the Program's regulations (or ensuring that the regulations would not produce a contrary result), the Program would achieve the following, which we believe are strongly in the interests of the Program and those impacted by it:

- Critically, a client employer could not avoid the Program's mandate (and thus prevent workplace access to the Program to its workers, including the opportunity for payroll deduction) by entering into a contract with a PEO that offers a retirement plan in situations where either (1) the client employer chooses not to make the PEO's retirement plan available to its workers or (2) the PEO only makes its retirement plan available to its own internal employees. Either situation would leave the workers covered by the PEO service contract without a work-based retirement savings option.
- A small business would not be subject to the Program's mandate at a date earlier than what the legislation intended for simply because it uses a PEO, which would often be the case if the "number of Employees" was determined at the PEO level.
- Employees of a small business that begins or terminates a relationship with a PEO would avoid being needlessly un-enrolled or re-enrolled in the Program if the "Employer" switched from the small business to the PEO or vice versa.
- A PEO that does not sponsor a retirement plan would avoid the myriad administrative complexities that would arise if it were a Participating Employer under the Program with respect to workers performing services for client employers in instances where the client employers have control over certain functions that the PEO would nevertheless be responsible for under Section 10005 of the draft regulations (e.g., setting up payroll deductions for the client's workers).
- A PEO that does not sponsor a retirement plan would not be required to automatically enroll a worker in the Program in cases where that worker already participates in a retirement plan sponsored by the client employer.
- In the case of a small business that does not co-employ 100% of its workforce, workers would avoid the confusion and fundamental unfairness that would result from finding themselves enrolled in the Program at different dates, as would often be the case if (1) the PEO is considered the Employer of the co-employed workers and is subject to one Registration Date, and (2) the client employer is the Employer of the non-co-employed workers and is subject to a different Registration Date (assuming neither the PEO nor the client employer is exempt from the Program). In addition, such small businesses would avoid the confusion of keeping track of which workers they would have responsibility for as the "Employer" under the program.

Ultimately, by ensuring the above principles and results are achieved, the Program will help provide workers and small businesses throughout California with a consistent experience and

uniform access to the Program regardless of whether the small business has entered into a contract with a PEO.

3. The Need for Further Clarification of Who the "Employer" is when a PEO Relationship is Present

Under the draft regulations, the "Employer" of an employee would generally be the individual or non-governmental entity that is determined to be an employer by applying the common law rules for determining employer/employee status. However, in the case that "an individual or entity contracts to supply an employee to perform services for a customer or client," then subdivisions (b)-(d) in Unemployment Insurance (UI) Code Section 606.5 would be used to determine whether the individual/entity *or* the customer/client is the employer of a particular employee (rather than the common law test).

We read the cross reference to UI Code Section 606.5 as being intended to clarify for purposes of the Program which party is the employer of an employee in a tri-party employment situation. As noted above, we very much appreciate that Program staff understand the importance of the regulations providing clarity in this regard, and we agree that addressing tri-party employment relationships within the definition of "Employer" is an effective way to achieve this goal. However, we request that further clarification specifically addressing PEO relationships be added to the definition. This addition (language for which is suggested in part four below) is necessary to ensure (1) consistent treatment of PEO clients under the Program and (2) consistent and equitable treatment by the Program of the variety of types of employment relationship – traditional two-party relationships, temporary and staffing agency relationships, and co-employment (i.e., PEO) relationships.

The additional clarification we seek stems from the fact that UI Code Section 606.5 was not drafted with PEOs in mind, and there is otherwise no clear PEO-specific provision in the California statutes. Section 606.5 was drafted years ago to address the UI responsibilities of temporary agencies and more traditional employee "leasing" companies,[4] neither of which specifically address co-employment relationships. In the PEO context, it is not always clear under Section 606.5 whether the PEO would be the employer, and the answer may vary by PEO or even by client based on the services that a client contracts with the PEO to receive. Further confusing the matter, for purposes of the draft regulations, in the case that a PEO is determined *not* to be the employer under Section 606.5, then Section 606.5(c) provides that the PEO pays the employee's wages as the agent of the employer. For a variety of reasons, PEOs are not agents of their client employers.

For the policy reasons and Program objectives discussed in part two above, ***it seems to us that the intent of the draft regulations and the reference to UI Code 606.5 was for the client employer to be the employer for purposes of the Program instead of the PEO***. This result would be consistent with the treatment of PEOs and their clients under the final rules for OregonSaves. However, for the reasons noted above, the draft regulations would not consistently produce this result in employment situations involving a PEO. We have therefore suggested below some language that we believe would preserve the draft regulation's treatment

[4] Although PEOs have historically been known as employee leasing companies, that term is outdated and generally no longer adequately represents the modern PEO business model.

of traditional two-party employment relationships, temporary agencies, and staffing companies, while also ensuring that a PEO and its client employers are treated consistently vis-à-vis other PEOs and their clients.

4. RECOMMENDED CHANGES TO THE DRAFT REGULATIONS

Pursuant to the discussion above, NAPEO respectfully recommends that staff amend the draft regulations as follows in order to provide for the consistent treatment of PEOs and their client employers under the Program and to better achieve the Program's policy objectives in terms of coverage goals and administrative simplicity.

a. Recommended changes related to the definition of Employer to clarify that the client employer, and not the PEO, is the Employer under the Program.

Section 10001. Additional Definitions

(n) "Employer" means an individual or non-governmental entity engaged in a business, industry, profession, trade, or other enterprise in the state, whether for profit or not for profit, determined to be an employer under common law rules applicable in determining an employer-employee relationship, except as provided in subdivisions (b)-(d) in Unemployment Insurance Code Section 606.5. Notwithstanding the preceding sentence, solely for purposes of the Program, in the case of an Employee who is covered by a contract described in Section 10001(u) of these regulations between a Professional Employer Organization and a client or customer, the client or customer (and not the PEO) is the Employer of such Employee.

…

(u) "Professional Employer Organization" or "PEO" means an individual or non-governmental entity that enters into a contract substantially meeting the requirements of Internal Revenue Code Section 7705(e)(2)(A)-(E) (without regard to the word "certified" in subparagraph (C)) with a client or customer under which the PEO takes on certain mutually agreed-upon employer responsibilities with respect to the workers performing services for the client or customer who are covered by the contract.[5]

(v)~~(u)~~ "Program" means…

[5] Unlike a number of states, California's statutes do not contain a definition of PEO for any purpose. We have therefore recommended a definition of "Professional Employer Organization" that incorporates certain contract requirements that are standard for and generally unique to PEOs, and that are enumerated as part of the Internal Revenue Service's voluntary certification program for PEOs as provided for in the Internal Revenue Code (although IRS certification would not be required to be considered a PEO for purposes of our suggested definition).

b. Recommended changes to the definition of Employee to accommodate PEO relationships.

The draft regulations would define "Employee" in part as an individual who "receives an IRS Form W-2 ("W-2") with California wages *from an Eligible Employer*" (emphasis added). In most types of employment relationships, the individual or entity who is the "Eligible Employer" for purposes of the Program will be the same person who provides the W-2 to the Employee. However, because PEOs generally issue W-2s to workers as part of the tax reporting services they perform for client employers, that would not be the case if a PEO's client is the "Eligible Employer." We therefore recommend the following changes to the definition of "Employee" to ensure that the definition is workable with respect to individuals who are covered by a contract between a PEO and client employer.

Section 10001. Additional Definitions

(k) "Employee" means any individual who (1) is a resident of California, or a non-resident with California source income, (2) under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee under

Unemployment Insurance Code Sections 621 et seq., and (3) who receives an IRS Form W-2 ("W-2") with California wages from an Eligible Employer or from a Professional Employer Organization with respect to services the individual performed for an Eligible Employer.

c. Recommended changes to accommodate the ways in which Form DE 9C is filed in employment relationships involving a PEO.

The draft regulations would rely on data as reported on the DE 9C for purposes of determining the "number of Employees" that an Employer has, which is in turn relevant for determining (1) whether an Employer is exempt from the Program and (2) the Registration Date of an Eligible Employer. In this regard, we recommend that the changes shown below be made to ensure that the number of Employees an Employer has is appropriately determined when a PEO relationship is present.

As noted above, PEOs utilize a variety of business models and approaches to how they execute the services they provide to client employers. As a result, in some cases a PEO may submit the Form DE 9C on behalf of a client using the client employer's account number, whereas other PEOs may submit the form in aggregate for all clients with workers in California using the PEO's own account number. California's Employment Development Department (EDD) has generally accepted a PEO's use of either method. Moreover, a client employer that does not co-employ 100% of its workforce would report its non-co-employed workers on one DE 9C while the PEO would generally be responsible for reporting the co-employed workers on a separate DE 9C (whether under the client employer's account number or the PEO's).

Regardless, we believe that the intent of the draft regulations is to determine the number of Employees that an Employer has based on a count of all Employees reported on the Form DE 9C who have wages attributable to services performed for a client employer, regardless of whether

that Employee was reported under the client employer's account number or the PEO's account number.[6] We therefore suggest the following changes:

Section 10001. Additional Definitions

(o) "Exempt Employer" means an Employer that either (i) has fewer than five Employees ~~as~~ reported on ~~the~~a DE 9C for the quarter ending September 30 of each Program Year; or (ii) that provides or contributes to a Tax-Favored Retirement Plan (including a Tax-Favored Retirement Plan offered through a PEO); or (iii) is the federal government, the state, any county, any municipal corporation, or any of the state's units or instrumentalities. If an Employer has entered into a contract with a PEO as described in Section 10001(u) of these regulations, the reference to the DE 9C reporting in the preceding sentence shall include: (A) any DE 9C filed under the Employer's account number; and (B) any DE 9C filed under the applicable PEO's account number, but only to the extent that an Employee reported on the PEO's DE 9C performed services for the Employer.

Section 10003. Employer Registration and Employee Enrollment

(e) For purposes of subsection (c), the number of Employees an Eligible Employer employs shall be the number of Employees as reported on a DE 9C for the quarter ending September 30 in the calendar year preceding the calendar year in which the Registration Date occurs.[7] If an Employer has entered into a contract with a PEO as described in Section 10001(u) of these regulations, the reference to the DE 9C reporting in the preceding sentence shall include: (A) any DE 9C filed under the Employer's account number; and (B) any DE 9C filed under the applicable PEO's account number, but only to the extent that an Employee reported on the PEO's DE 9C performed services for the Employer.

Section 10004. Employer Exemptions

(a) An Employer shall be exempt from the Program if:

(1) The Employer employs fewer than five Employees as reported on the DE 9C for the quarter ending September 30 of each Program Year;

(2) The Employer provides or contributes to a Tax-Favored Retirement Plan (including a Tax-Favored Retirement Plan offered through a PEO); or

[6] This necessary change further demonstrates the need for a specific PEO rule to best achieve the Program's objectives. For example, assume there is a PEO client with 14 employees, 10 of whom are covered under a PEO co-employment relationship. Without the changes we are recommending, 10 employees would receive a W-2 from the PEO (as required by federal law) and the 4 who are not in the tri-party relationship (and who receive a W-2 from the client employer) would be excluded from potential participation in the Program because the client employer could claim an exemption for having fewer than 5 employees as reported on the DE 9C.

[7] This suggested change is intended to clarify which DE 9C applies with respect to a particular Registration Date. Thus, if one Registration Date is July 1, 2019, the number of Employers would be determined by reference to the DE 9C filed for the quarter ending September 30, 2018.

(3) The Employer is the federal government; the state; any county; any municipal corporation; or any of the state's units or instrumentalities.

For purposes of this subsection, if an Employer has entered into a contract with a PEO as described in Section 10001(u) of these regulations, the reference to the DE 9C shall include: (A) any DE 9C filed under the Employer's account number; and (B) any DE 9C filed under the applicable PEO's account number, but only to the extent that an Employee reported on the PEO's DE 9C performed services for the Employer.

d. Recommended change to clarify that PEOs may assist clients with Program compliance.

For the reasons stated above, we strongly believe that a PEO's client (and not the PEO) should be the Employer for purposes of the Program with respect to the covered workers performing services for the client employer. If this is the outcome that the regulations adopt, then for those client employers that become Participating Employers under the Program, we expect that PEOs would generally offer their services to assist those clients with any duties they would have as Participating Employers (just as PEOs provide their small business clients with assistance with respect to similar such tasks and responsibilities in other contexts). Thus, in order to provide clarification and avoid any questions with respect to whether such assistance from a PEO would be allowed, we recommend the following addition to Section 10005.

Section 10005. Participating Employer Duties

(10) Nothing in these regulations shall prohibit a Professional Employer Organization from entering into a contract as described in Section 10001(u) with a client or customer that is a Participating Employer under which the PEO is to assist the client or customer in the performance of some or all of a Participating Employer's duties under these regulations.

5. OTHER TECHNICAL AND PROCEDURAL RECOMMENDED CHANGES NOT SPECIFIC TO PEOS

Although not unique to PEO relationships, NAPEO has the following additional comments on the draft regulations at this time:

- ***Need to Further Limit the Responsibilities of Participating Employers*:** To the extent practicable, we would urge the staff to explicitly limit Participating Employers' responsibilities with respect to Program-related tasks throughout the draft regulations. Many of the tasks enumerated in the draft regulations can and should be performed by the Administrator in order to minimize Participating Employers' administrative burdens and to better ensure that the Program is operated in a manner consistent with the U.S. Department of Labor's guidance relating to non-ERISA payroll deduction IRAs. However, the draft regulations are silent in many instances with respect to whether the Administrator or the Participating Employer (or another party) would be responsible for a particular task, or they otherwise leave open the possibility that a process could subsequently be developed that places additional administrative duties on Participating Employers.

For example, Section 10006(b)(2) states that a Participating Employee may opt out of Automatic Escalation at any time by following procedures established by the Administrator, but that language leaves open the possibility that the Participating Employer could be made responsible for collecting and tracking those opt-out requests under the procedures developed by the Administrator. Section 10006(b)(3) presents a similar concern with respect to a Participating Employee's ability to change his or her Automatic Escalation amount (seemingly also at any time).

- ***Definition of "Tax-Favored Retirement Plan"*:** We suggest that the definition of "Tax-Favored Retirement Plan" in Section 10001(z) be amended by adding a specific reference to 401(k) plans. Although we assume that the draft definition's inclusion of plans that are "intended to be tax qualified under Internal Revenue Code Section 401(a)" would include 401(k) plans, people are generally more familiar with the term "401(k) plan" and we believe it could help avoid potential confusion by specifically including the term.

- ***Need to Clarify Employer Requirements with respect to Participating Individuals*:** Section 10006(c)(2) of the draft regulations states that the Program may establish processes and procedures for Participating Individuals' transactions with the Program, including payroll Contributions. In this regard, we request clarification that no employer of a Participating Individual is required to offer or facilitate payroll Contributions to the Program on behalf of the Participating Individual unless (1) the employer is a Participating Employer for purposes of the Program and (2) the Participating Individual is also a Participating Employee with respect to that employer/Participating Employer.

  In addition, we request clarification that, in the event that an employer chooses to allow a Participating Individual to make Contributions to the Program via payroll deduction, such employer does not become responsible for any of the Participating Employer duties such as those listed in Section 10004, except for withholding and remitting such Contributions to the Administrator.

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Once more, we appreciate your consideration of our comments on the draft regulations for the Program. Should you have any questions with respect to the issues discussed herein or NAPEO's position on such matters, please contact me at (503) 345-2486 or Daniel Harris of NAPEO at (703) 739-8173.

Sincerely,

Craig Ahlswede
Chair, NAPEO CA Leadership Council
President, Allevity HR & Payroll